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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

October 3, 2000

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Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: EX PARTE -- CC Docket No. 00-176: Application of Verizon Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide InterLATA Services in Massachusetts

Dear Ms. Salas:

On October 2, 2000, Michael Pelcovits, Mark Bryant (by telephone), Chris Frentrup, Paul Bobeczko, Vijetha Huffman, Nory Miller and I on behalf of WorldCom, Inc. met with Jane Jackson, Rich Lerner, Noel Uri, Renee Terry, Carol Canteen (by telephone), Jennifer McKee and Richard Kwiatkowski of the Competitive Pricing Division to discuss our TELRIC analysis of whether UNE prices are cost-based in Massachusetts and local call-flow information, as set forth in the attached materials which were provided at the meeting. Following the meeting, the electronic spreadsheet for the TELRIC analysis was provided to Richard Kwiatkowski as requested, and is enclosed on diskette.

In accordance with section 1.1206 of the Commission's rules, 47 C.F.R. § 1.1206, an original and one copy of this Notice are being filed with your office.

Sincerely,

Keith L. Seat

Enclosures

cc (w/o encls.): Jane Jackson, Rich Lerner, Noel Uri, Renee Terry, Carol Canteen, Jennifer McKee and Richard Kwiatkowski

cc: (w/encls.): Susan Pie, Josh Walls and Cathy Carpino

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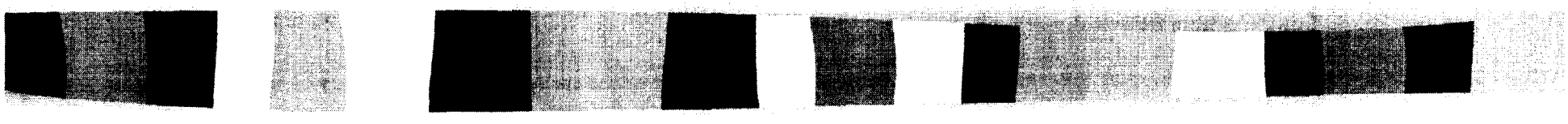
Date: Mon, 02 Oct 2000 15:48 -0400 (EDT)
From: Chris Frentrup <Christopher.J.Frentrup@wcom.com>
To: Richard Kwiatkowski <RKWIATKO@fcc.gov>
Subject: Re: Analysis of Verizon's MA UNE Prices

Attached is the spreadsheet we used. The references in this sheet to Workpapers and Exhibits are to the February 14, 1997 NYNEX compliance filing in Massachusetts. Call me if you need help understanding how it works.

We will include this as part of our ex parte for today's meeting, unless you tell me that we don't need to file it at all.

Chris
202 887-2731

UNE-P Price Squeeze Prevents Robust Local Competition-- TELRIC Analysis



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WORLDCOM

Scope of Analysis of MA UNE Switching Rates

- Focus of analysis is cost study upon which state approved UNE rates are based
- To date, analysis only of switch costs (port and usage)
- Corrected costs are substantially below both state approved rates and Z-Tel "promotional" rates

MA UNE Switching Rates Are N*ot* Cost-Based

- Verizon cost study is based on unreasonable inputs and assumptions that are inconsistent with values adopted by FCC and other states
- Cost results are completely out of line with both other states and FCC cost model results
- Dramatic differences in switching cost from other Verizon states with similar characteristics

Two Analyses of Verizon Results Are Performed

- Micro: Examine effect on cost estimates of using inputs in line with those used in other proceedings
- Macro: Compare aggregate investment to output from FCC's model and Verizon's own accounting data

Micro: Specific Issues with Verizon "TELRIC" Cost Study

- Installation Multiplier
- Switch Discount Factor
- Busy Hour Conversion Factor
- Utilization Factor
- Cost of Capital
- Building Factor
- Power Factor

Installation Multiplier

- Installation multiplier of 1.654 is applied to switching investment to estimate the cost of engineering and installing switch in wire center
- In other words, 65.4% of the investment in the switch is added to represent installation costs. Verizon claims this is based on accounting data
- Dramatically higher than value reported by other ILECs, which use figures in range of 8%-12%
- Use of a 10% factor (multiplier of 1.1) reduces switching costs by 23% on usage and 33% on port

Switch Discount

- Verizon switching investments are based on discounts off switch "list prices" assuming purchase of growth capacity, rather than initial purchase of the switch
- Contrary to TELRIC principles: FCC rejected...

  "...the suggestions of Ameritech, Bell Atlantic, BellSouth, GTE, and Sprint that the costs associated with purchasing and installing switching equipment upgrades should be included in our cost estimates. The model platform we adopted is intended to use the most cost-effective, forward-looking technology available at a particular period in time. The installation costs of switches estimated above reflect the most cost-effective forward-looking technology for meeting industry performance requirements. Switches, augmented by upgrades, may provide carriers the ability to provide supported services, but do so at greater costs. Therefore, such augmented switches do not constitute cost-effective forward-looking technology." (FCC No. 99-304, para. 317)

- No evidence on specific numbers used by Verizon in MA UNE proceeding, but the discount factor has a significant impact
- Assuming 60% initial purchase discount vs. 10% growth discount, effect is reduction in switching costs of 38% on usage and 55% on port

Busy Hour Conversion Factor

- Busy hour conversion factor is applied to switching cost to convert busy hour costs (costs at peak usage period) to average minute-of-use costs
- Verizon factor recognizes only usage occurring during business days - no weekend usage is considered
- Weighting weekend days at only half the usage of business days reduces usage costs by 19.2%

Utilization Factor

- Utilization factor is applied to switch port investment to reflect theoretical "fill" of total capacity
- Verizon value is 85.25%, (citing "Engineering" experts)
- By contrast, Bell Atlantic and SBC used values in FCC's ONA proceedings in range of 90%+
- Substitution of 90% utilization factor reduces port costs by 9.9%

Cost of Capital

- Cost of Capital factor reflects the cost of debt and equity, capital structure, depreciation, and income taxes
- Verizon value for overall capital cost is 12.16% - noticeably above FCC-approved cost of capital of 11.25%
- Capital structure is heavily weighted to equity (75% equity) which inflates tax burden
- Use of FCC-approved capital cost and capital structure reduces port and usage costs by 7.6%

Building Factor

- Building factor is applied to switch investment to estimate the cost of the building that houses switch
- Verizon develops this factor by dividing all embedded building investment by investment in wire center-related accounts to obtain factor of 18.4%
- This method assigns all building investment to switching, ignoring other uses of buildings (for office workers, sales, management, etc.)
- Correct calculation based on Verizon approach yields factor of 14.6%, which reduces port and usage costs by 3.4%

Power Factor

- Power factor is applied to switching investment to estimate the cost of supplying power to switch, including batteries and generators for emergency power
- Verizon value is 10.7%, much higher than that adopted by FCC. Verizon itself recently filed a value of 5% in New York UNE proceeding
- Use of FCC-approved value of 8% decreases switching costs by 2.4% for port and 1.7% for usage

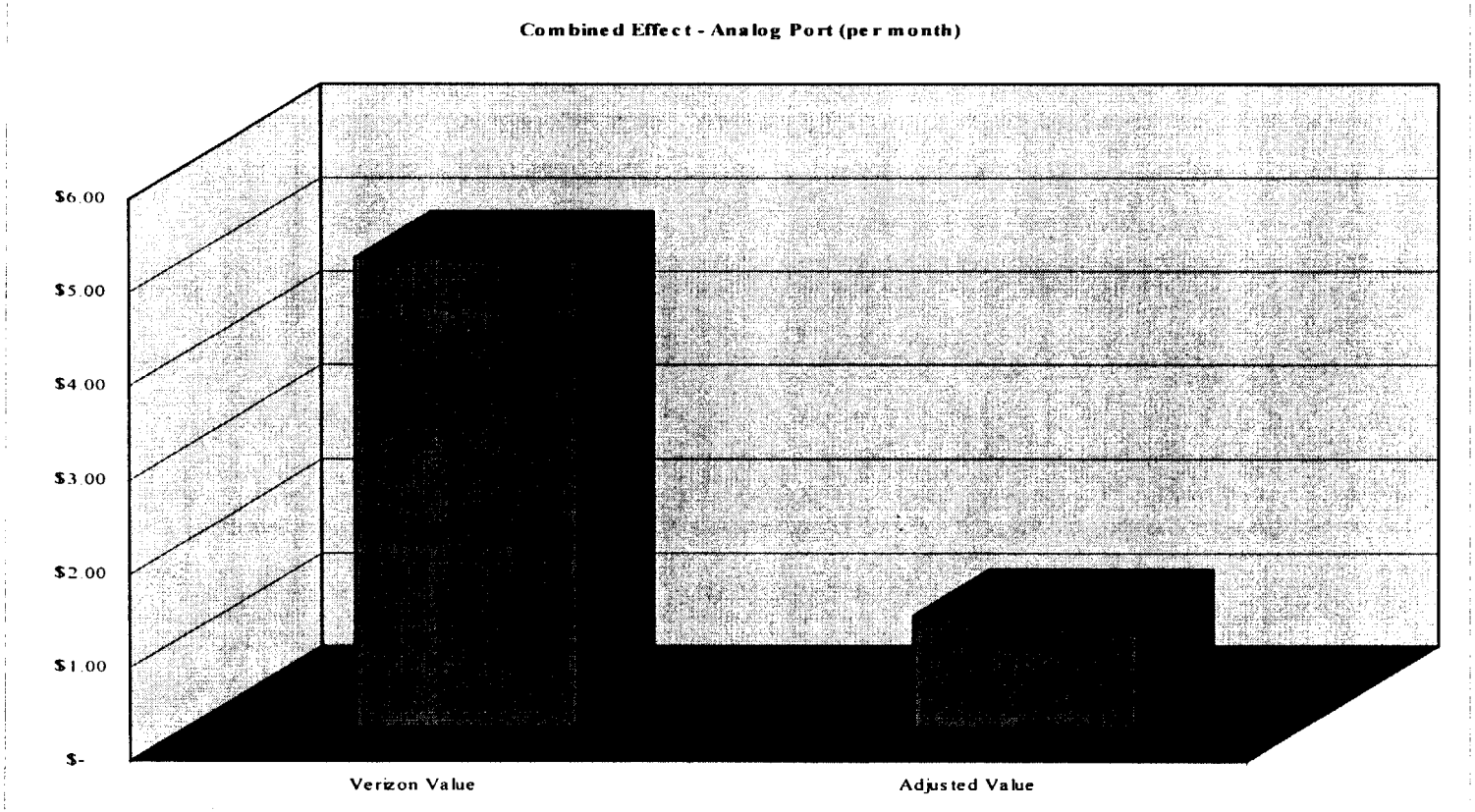
Combined Effect

- Compared to state approved rates, the effect of all these adjustments is to reduce switch port costs by 76% and switch usage costs by 62.9%
- Compared to Z-Tel "promotional" rates, the effect of all adjustments is to reduce switch port costs by 76% and switch usage costs by 47%

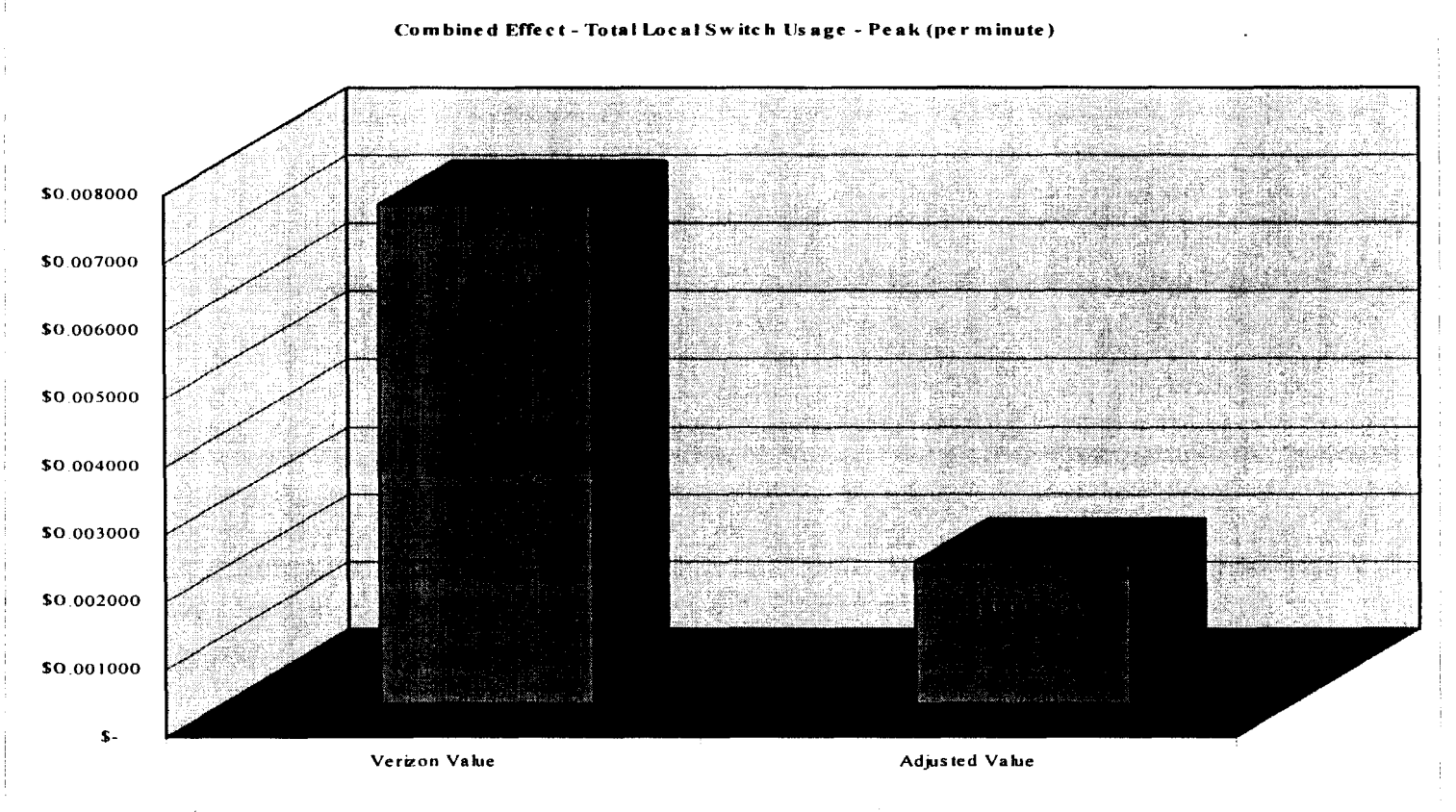
Combined Effect -- Summary

	Port	Usage
Installation Multiplier	33.0%	22.9%
Switch Discount Factor	55.0%	38.0%
Busy Hour Conversion Factor	0.0%	19.2%
Utilization Factor	9.9%	0.0%
Cost of Capital	7.6%	7.6%
Building Factor	3.4%	3.4%
Power Factor	2.4%	1.7%
Required Reduction of State Approved Rates	76.0%	62.9%
Required Reduction of Z-Tel Rates	76.0%	47.0%

Combined Effect - Switch Port



Combined Effect (DTE)- Local Switch Usage



Macro: Total Switching Investment in Verizon Cost Study Is Unreasonably High

- Switching investment is reported directly in Verizon's cost study workpapers
- These investments can be compared to two other sources:
  - FCC's TELRIC cost model, the HCPM
  - Embedded costs in Verizon's accounting records

Total Switching Investment in the Verizon Study Is >$2B

- The cost of the switching equipment itself is estimated to be $1.3 billion
- Verizon multiplies the switching investment by a 1.654 installation factor, which yields a total investment of $2.2 billion
- Then, Verizon adds a 1.1 factor for power equipment, yielding a total investment of $2.4 billion
- Verizon adds $0.2 billion in Right-To-Use fees
- For valid comparison to the FCC model, it's necessary to subtract the cost of ISDN and other non-basic services. These amount to $0.5 billion, yielding a net investment of $2.1 billion

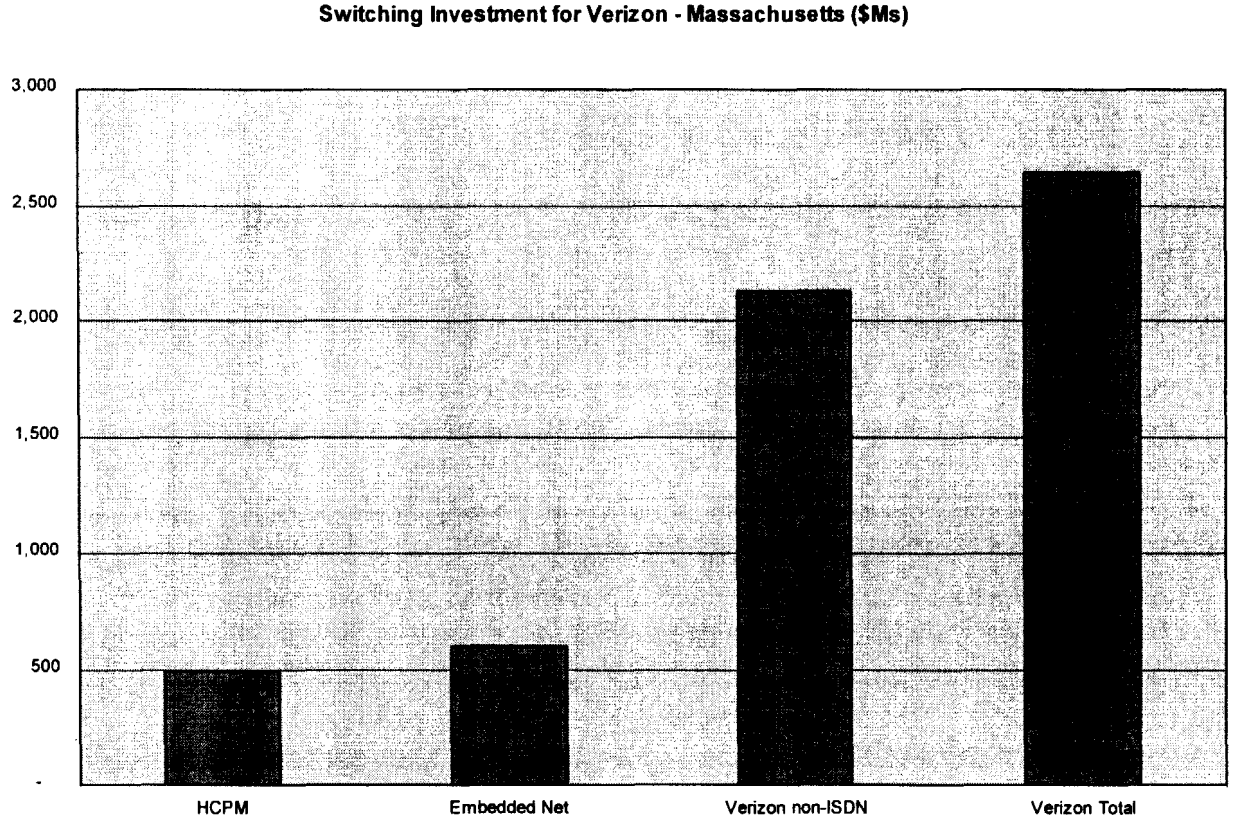
FCC's TELRIC Model Estimates $0.5 Billion of Investment in Switching Equipment

- FCC TELRIC model is based on analysis by Prof. David Gabel and Scott Kennedy of actual contracts for switching equipment by ILECs between 1989 and 1996
- These switching cost estimates include installation, RTU fees, and power
- This estimate should be directly comparable to Verizon investment estimates
- The HCPM cost estimate is 77% lower than the Verizon cost estimate

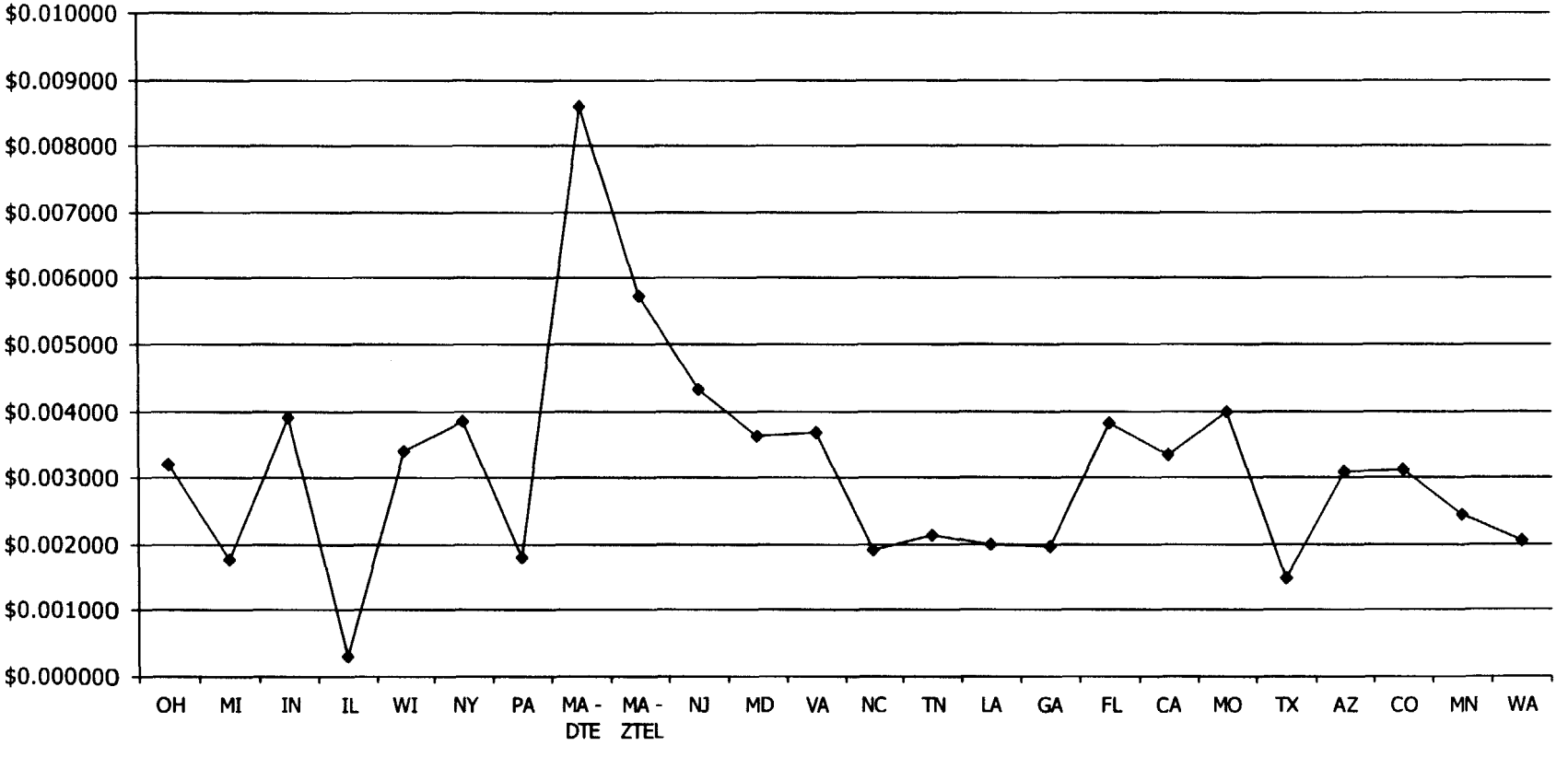
Verizon's Embedded Switching Costs is 23% of Verizon "TELRIC" Cost Estimate

- Verizon's Gross Local Switching Plant in Service in MA was $1.4B in 1995 (the time of the "TELRIC" study)
- The "net book value" of this equipment subtracts accumulated depreciation reserve from gross plant
- The depreciation reserve in MA is 57% of gross plant, yielding an estimated net plant value of $600 million
- Comparable figure from Verizon study is $2.6B
- This also indicates that Verizon number should be reduced by 77% to yield a more reasonable estimate of switching costs

Verizon's Estimate of Switching Investment Far Exceeds FCC Model and Booked Amounts

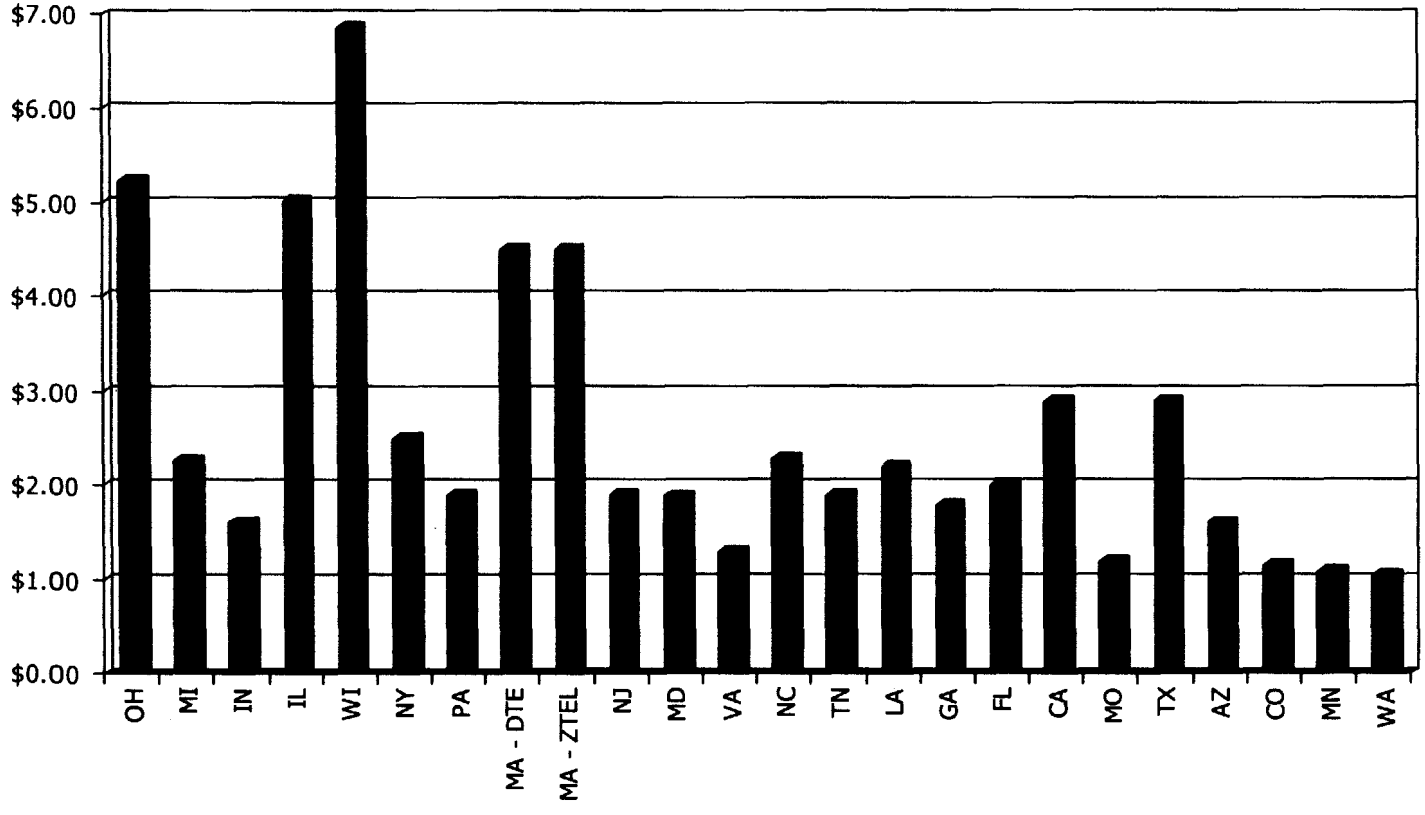


Effective Switching Rate by BOC Market



- Rates have been calculated by dividing the estimated monthly switching and transport costs per line by total local and long distance minutes (originating & terminating)
- All Markets assume 1,200 originating local minutes and 1,200 terminating local minutes, but LD minutes are market-specific based on WorldCom experience
- The switching rates in IL is zero; therefore the effective switching rate is the result of other elements like transport

Port Rates by BOC Market



- The port charge in IL includes unlimited switching at no extra charge (i.e, the switching rate is zero)